

**CITY COUNCIL OF THE CITY OF SAN DIEGO
SUPPLEMENTAL DOCKET NUMBER 2
FOR THE REGULAR MEETING OF
TUESDAY, NOVEMBER 23, 2004 AT 10:00 A.M.
CITY ADMINISTRATION BUILDING
COUNCIL CHAMBERS – 12TH FLOOR
202 “C” STREET
SAN DIEGO, CA 92101**

ADOPTION AGENDA, DISCUSSION, OTHER LEGISLATIVE ITEMS

RESOLUTIONS:

ITEM-S500: Amendment to the Retention Agreement with Vinson & Elkins to Provide Representation before the Securities & Exchange Commission and to Perform Additional Investigation with Respect to the Audit of the City’s FY 2003 Financial Statements.

CITY ATTORNEY’S RECOMMENDATION:

Adopt the following resolution:

(R-2005-535)

Authorizing and directing the City Manager to execute an amendment to the retention agreement with Vinson & Elkins (V&E) for an additional amount not to exceed \$350,000 for services related to the conduct of additional investigation concerning the City’s FY 2003 basic financial statements, and for continued representation before the Securities & Exchange Commission (SEC).

SUPPORTING INFORMATION:

The City previously retained the law firm of Vinson & Elkins to prepare an internal report on the City's securities disclosure practices from 1996 through the present, and to provide representation of the City before the Federal Securities & Exchange Commission (SEC) with respect to an investigation by the SEC. The total contract amount authorized by the City Council for those purposes was in an amount not to exceed \$2.0 million. Vinson & Elkins delivered its report to the City, and has been continuing to represent the City before the SEC, primarily at this time focused on responding to document requests and other requests for information.

ADOPTION AGENDA, DISCUSSION, OTHER LEGISLATIVE ITEMS

RESOLUTIONS: (Continued)

ITEM-S500: (Continued)

SUPPORTING INFORMATION: (Continued)

As is well known, the City's FY 2003 CAFR has not been finalized and issued. The City Manager retained the firm of KPMG, LLP to perform the audit of the City's FY 2003 basic financial statements. Pursuant to accounting standards and practices, the City needs to conduct additional investigation beyond the scope of the Vinson & Elkins Report on Investigation to address issues relating to the financial statements. The additional investigation is necessary because the City's and KPMG's obligations with respect to allegations of illegal conduct in the context of an audit are broader than the investigation and reporting on federal disclosure law violations, the purpose for which the Vinson & Elkins Report was commissioned. The additional investigation will address legal issues and allegations of wrongdoing that were not the subject of the Vinson & Elkins Report.

V&E was retained to perform the additional investigation by the City Manager. The initial contract amount was not to exceed \$250,000. The City has also retained additional expertise to advise it in these matters, including the law firm of Susman Godfrey, which provides expertise in accounting law, and the firm Chicago Partners, which provides forensic auditing expertise. The City has been working cooperatively with KPMG on the scope and progress of the additional investigation, and a program for additional investigation has been prepared. In order to complete the additional investigation, additional funding for V&E's services is required. It is anticipated that an additional \$350,000 will be sufficient to conduct the additional investigation, although additional sums may be necessary to complete the additional investigation if the City and KPMG, working cooperatively through the investigation, determine additional investigative steps are appropriate.

Bradley/Ewell/LG

Aud. Cert. 2500496.

ADOPTION AGENDA, DISCUSSION, OTHER LEGISLATIVE ITEMS

RESOLUTIONS: (Continued)

ITEM-S501: Third Amendment to the Retention Agreement with KPMG, LLP (KPMG) to Perform an Audit of the City's FY 2003 Basic Financial Statements.

CITY MANAGER'S RECOMMENDATION:

Adopt the following resolution:

(R-2005-536)

Authorizing and directing the City Manager to execute an amendment to the retention agreement with KPMG, for an additional amount not to exceed \$500,000, for a total contract amount not to exceed \$1.7 million.

CITY MANAGER SUPPORTING INFORMATION:

On January 27, 2004, the City filed a voluntary financial disclosure concerning, in part, certain errors and correctible statements in the City's FY 2002 Comprehensive Annual Financial Report ("CAFR"). As a result, the FY 2003 CAFR has not been finalized and issued. The City Manager retained the firm of KPMG LLP to perform the audit of the City's FY 2003 basic financial statements, which are included in the CAFR, before the FY 2003 CAFR is finalized and issued. The preliminary estimate for the cost to initiate the audit was approximately \$500,000. On July 12, 2004 the City Council authorized the first amendment with KPMG to increase the not to exceed amount to \$800,000. Subsequently on August 9, 2004, the City Council authorized the second amendment with KPMG to increase the total not to exceed amount to \$1.2 million.

To date, KPMG has spent over 6,900 hours working on the Fiscal Year 2003 Financial Statements. The City has expended approximately \$1.14 million to date and currently has received additional invoices from KPMG for approximately \$327,498. KPMG's invoices are averaging \$70-80,000 every two weeks.

Pursuant to accounting standards and practices, the City needs to conduct additional investigation beyond the scope of the Vinson & Elkins Report on Investigation. The additional investigation is necessary because the City's and KPMG's obligations with respect to allegations of illegal conduct in the context of an audit are broader than the investigation and reporting on federal disclosure law violations, the purpose for which the Vinson & Elkins Report was commissioned, and the additional investigation will address legal issues and allegations of wrongdoing that were not the subject of the Vinson & Elkins Report. The City has been working cooperatively with KPMG on the scope of the additional investigation.

ADOPTION AGENDA, DISCUSSION, OTHER LEGISLATIVE ITEMS

RESOLUTIONS: (Continued)

ITEM-S501: (Continued)

CITY MANAGER SUPPORTING INFORMATION: (Continued)

Given the continued importance of a thorough review, the City Manager is requesting that the City Council authorize a third amendment with KPMG for an additional \$500,000 for a total contract amount of not to exceed \$1,700,000. The \$500,000 will be used to pay \$327,498 of existing KPMG invoices as well have funding authorized to pay future invoices.

Ewell/Irvine

Aud. Cert. 2500479.